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Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File No. S7-05-19
Amendments to Financial Disclosures about Acquired and Disposed Businesses

Dear Office of the Secretary:

This letter is the response of BDO USA, LLP to the proposed rule amendments referred to above.

We support the Commission's initiative to improve the effectiveness of the financial disclosure regime for acquired and disposed businesses. We appreciate the Commission's careful and thoughtful input given to the feedback it received on the 2015 *Request for Comment on the Effectiveness of Financial Disclosures about Entities Other than the Registrant*. From an overall perspective, we support the proposed amendments which aim to simplify and streamline the existing rules as well as those changes which incorporate staff guidance that is already widely applied in practice. We also commend the Commission for proposing to conform the rules applicable to smaller reporting companies with those of non-smaller reporting companies (where appropriate) as we believe it will codify current practice, reduce confusion, and simplify the application of the rules to such issuers.

Separately, we observe that the SEC staff has extensive application guidance within the Division of Corporation Finance's *Financial Reporting Manual* (FRM) on many of the rules affected by the proposed amendments. While some of this guidance was explicitly addressed within the proposing release, other guidance that was not explicitly addressed will contradict the rules if adopted as proposed. Accordingly, we encourage the SEC staff to publish an update to this guidance prior to, or simultaneous with, the effective date of the amendments to minimize confusion and ease transition. We also encourage the Commission to provide transition guidance within the adopting release before, or simultaneous with, the publication of the amendments in the Federal Register. As the objectives of the proposed amendments are intended to continue to provide material information to investors, facilitate more timely access to capital, and reduce registrant costs and burdens, we encourage the Commission to consider permitting application of the amendments in filings made on or after publication of the amendments in the Federal Register.

We have organized our other comments and recommendations as follows:

- Significance Tests for Acquired Businesses
- Financial Statements for Net Assets that Constitute a Business
- Foreign Businesses
- Registration Statements and Proxy Statements
- Financial Statements of an Acquired Real Estate Operation
- Pro Forma Financial Information
- Investment Company Considerations

Significance Tests for Acquired Businesses

Income Test – Revenue Component

We support the addition of a supplemental revenue test to the income test as we also believe it will reduce the circumstances where the income test (in isolation) produces anomalous results. As proposed, the registrant and the tested subsidiary must have "recurring annual revenue" in order to perform the revenue component of the test. The reference to "recurring" is unclear, which may result in inconsistent application of the test. Therefore, we encourage the Commission to clarify the meaning of "recurring annual revenue" (for example, is it intended to represent anything other than revenue reported in the last completed fiscal year, or alternatively, does the Commission intended to provide a level of flexibility in the amount of revenue included in the test).

Income Test – Income Component

While we agree that the proposed use of after-tax income for the income component of the test may simplify the income test's application for certain registrants, we do not believe the use of after-tax income will necessarily result in a meaningful significance calculation. We sense that the inclusion of income taxes may further distort the income test, particularly for entities affected by non-recurring tax effects. We also observe that the numerator and denominator may be inconsistent depending on the registrant's or acquired entity's tax status or structure (e.g., when a C corporation registrant acquires a non-taxable entity). It is not clear whether the use of after-tax income for simplicity purposes will result in fewer income test-related waivers. Accordingly, we encourage the Commission to retain the existing requirement to use pre-tax income amounts for the income component of the significance test.

Income Test – Income Averaging

We support the improvements to the income averaging calculation, but we believe there are opportunities for further clarification and improvement. Consistent with our view and rationale expressed above, we believe the income averaging calculation should be based on pre-tax, not post-tax, income amounts. We note that the proposed rules maintain the requirement to average net income for a period of five years. We wonder whether five years is the appropriate time period for the averaging calculation, or if a three-year average might yield a more meaningful outcome. Additionally, as the purpose of income averaging is to yield financial statement requirements that are material to investors, it

wasn't clear to us why the use of income averaging would be prohibited for registrants that also apply the revenue component of the test and believe the Commission should consider whether averaging should be permitted in both circumstances.

Investment Test

We also recommend that the Commission consider permitting the use of a more recent measurement date for the determination of total worldwide market capitalization in Proposed S-X Rule 1-02(w)(1)(i). We believe a more recent date may yield a more meaningful test of the investment's significance to the registrant as it would incorporate other relevant factors that impact market capitalization (e.g., completed acquisitions or dispositions since year end and reported interim financial results). For example, the measurement date could be based on the balance sheet date included in or filing date of a registrant's last periodic report on Form 10-K or Form 10-Q preceding the acquisition.

Moreover, we recommend the Commission consider permitting the use of an estimated offering price as of the expected offering date as a proxy for worldwide market capitalization in the denominator of the investment test (instead of total assets as of the end of the most recently completed fiscal year) for equity IPO candidates. This approach would achieve greater alignment between the significance calculations for such candidates with existing registrants. However, as significance of the acquisition would be based only on an estimate until the pricing date (and pricing may not be in line with initial expectations), we anticipate that additional application guidance would be needed (e.g., would an entity be required to remeasure significance under the investment test if the actual offering price differs from the estimated price by a specified threshold). Alternatively, the Commission could further consider whether the investment test should be excluded as a measure of significance for IPO candidates.

Financial Statements for Net Assets that Constitute a Business

We support the amendments that largely codify the staff's current practice of permitting the use of abbreviated financial statements when certain criteria are met. However, we observe that neither the proposed rules nor the proposing release addresses the applicability of carve-out financial statements that the staff currently accepts if it is impracticable to prepare the full financial statements required by Regulation S-X. We recommend that the Commission clarify under what circumstances carve-out financial statements would be appropriate.

Foreign Businesses

We believe the Commission should consider whether (further) outreach should be performed as it relates to accepting the use of International Standards on Auditing (ISAs) in audits of financial statements of acquired foreign businesses. ISAs are recognized as high quality standards that are largely converged with US GAAS. Despite being largely

converged, the requirement to obtain US GAAS audits adds time and cost to the compliance process.

We also believe the Commission should consider whether the financial statement requirements applicable to a business that would be a foreign private issuer in Proposed S-X Rule 3-05(d) should be the same as those applicable to an acquired or to-be acquired foreign business in Proposed S-X Rule 3-05(c).

Registration Statements and Proxy Statements

Omission of Rule 3-05 Financial Statements for Businesses That Have Been Included in the Registrant's Financial Statements

We generally support the proposed amendments that simplify the financial statement requirements for acquired businesses in a registration statement. However, we observe that the reporting for an acquisition that is at least 20%, but not more than 40% significant, is more onerous under the proposal than the current rules. The proposal permits omission of such financial statements from a registration statement only if the business has been included in the post-acquisition audited results for a complete fiscal year, while current rules permit omission of such financial statements if the business has been included in the post-acquisition audited results for at least nine months. We believe the Commission should consider preserving the current requirements for acquisitions that are at least 20%, but not more than 40% significant (in which nine months satisfies the one-year requirement) and permitting omission of S-X Rule 3-05 financial statements for a 40% or more significant acquisition only if the acquired business has been included in the post-acquisition financial statements for a complete fiscal year.

Disclosure Requirements for Individually Insignificant Acquisitions

In the proposing release, the Commission highlighted that the proposed amendments to the disclosure requirements for individually insignificant acquisitions are intended to reduce the burdens (cost and delayed access to capital) associated with preparing disclosure about immaterial acquisitions. As the Commission considers the final amendments, we believe the Commission should be aware that underwriters may still request audits or reviews of historical target financial statements in connection with their due diligence procedures in an offering, which may still impose costs and delayed access to capital. In securities offerings, underwriters frequently request auditors to provide negative assurance on the application of pro forma adjustments to historical amounts in pro forma financial statements and whether the pro forma financial statements comply as to form in all material respects with the applicable accounting requirements of S-X Rule 11-02. In the case of a business combination, PCAOB Auditing Standard 6101, *Letters for Underwriters and Certain Other Requesting Parties,* (AS 6101) requires the historical financial statements of each constituent part of the combined entity on which pro forma financial information is based to be audited or reviewed in order to provide such negative

assurance comfort. If auditors are unable to provide such comfort, underwriters will likely need to do more work with management as part of their due diligence process.

Other

S-X Rule 3-05(b)(1) states that "if securities are being registered to be offered to security holders of the business to be acquired, the financial statements specified in S-X Rule 3-01 and 3-02 shall be filed for the business to be acquired, except as provided otherwise for filings on Form N-14, S-4, or F-4." As there is typically a Form requirement that specifies the required financial statements in these circumstances, it isn't clear when this requirement is applied in practice. In connection with the proposed amendments, we recommend the Commission consider clarifying when the requirement to provide the periods specified in S-X Rule 3-01 and 3-02 would apply (particularly as the financial statement periods required by this rule are more than what is required for other acquisitions) or removing S-X Rule 3-05(b)(1) if it is not considered necessary.

Financial Statements of an Acquired Real Estate Operation

We support the amendments to S-X Rule 3-14 for acquired real estate operations that provide greater alignment with the reporting requirements for acquired businesses under S-X Rule 3-05 and incorporate staff interpretations from the FRM.

Blind Pool Real Estate Offerings

We believe the Commission should consider aligning the significance tests for blind pool real estate offerings whether for acquisitions of acquired businesses within the scope of S-X Rule 3-05 or for acquisitions of real estate operations within the scope of S-X Rule 3-14. The rationale provided in the release for use of the adapted significance tests appears to apply to both types of offerings (e.g., the nature of a blind pool investment, the supplemental undertakings, etc.).

Triple Net Leases

The Commission's proposal does not differentiate the financial statement requirements for an acquired real estate operation subject to a triple net lease with a single lessee from those of other acquired real estate operations. We defer to investors on whether S-X Rule 3-14 financial statements for such acquisitions provide them with decision-useful information. However, we observe that the elimination of this requirement appears inconsistent with the concepts that underlie the requirements in Staff Accounting Bulletin 1.I, *Financial Statements of Properties Securing Mortgage Loans,* and S-X Rule 3-09. The Commission may wish to consider this historical guidance in connection with its consideration of the proposed amendments.

If the Commission requires additional disclosures related to the lessee or guarantor of the lease (e.g., summarized unaudited financial information) in response to feedback on the

proposal, we do not believe these disclosures should be required in the financial statements of the registrant.

Other

Additionally, we observe that Proposed S-X Rule 3-14(c)(2)(iii) requires information about a real estate operation's "operating, investing, and financing cash flows, to the extent available." As S-X Rule 3-14 financial statements consist only of statements of revenues and expenses which exclude expenses not comparable to the proposed future operations (e.g., mortgage interest, depreciation, corporate overhead, etc.), it is not clear why incremental historical cash flow information that may not be consistent with the proposed future operations would be required.

Pro Forma Financial Information

Article 11 Framework and the Use of Management Adjustments

We support the Commission's objective to make pro forma financial information more useful for investors by the introduction of management's adjustments (MAs). However, we believe the scope of what may be included in MAs is perhaps overly broad and are concerned about the potential misinterpretation of what adjustments qualify as "reasonably estimable synergies…that have occurred or are reasonably expected to occur." As is pointed out in the proposing release, MAs "might contain forward-looking information" that would be covered by a safe harbor. It is possible that some may interpret the ability to provide forward-looking information in MAs with the ability to provide forecasted information in pro forma financial statements. Accordingly, we believe additional interpretive guidance, other illustrative examples, and clarification of how the Commission defines "reasonably estimable" and "reasonably expected to occur" are required to more appropriately limit the types of synergies and estimates that can be reflected in pro forma financial information as MAs.

Separately, we believe the Commission could consider an alternative to the proposed Article 11 framework. Under Proposed S-X Rule 11-02(a)(6)(i), we note that the "Transaction Accounting Adjustments" would be limited to adjustments to account for the transaction using the measurement date and method prescribed by the applicable accounting standard. Accordingly, other adjustments which may be unrelated to the accounting for a transaction but are directly attributable to the transaction and factually supportable (and as it relates to the income statement, expected to have a continuing impact), will presumably be reflected in the MA column. As a result, the MA column in pro forma financial statements will reflect both adjustments that are highly subjective and involve significant judgment with adjustments that are objective and involve little judgment. We believe the Commission may wish to consider preserving the current criteria in S-X Rule 11-02(b)(6) which yield only the isolated and objectively measurable effects of a particular transaction and require disclosure of such effects in a single column. The MA column would be reserved for communicating the effects of management actions or other events that do not meet the factually supportable criterion. Doing so may help investors better distinguish and understand the cumulative impact of adjustments that

are objective from those that may not ultimately come to fruition (even if "reasonably expected" to occur as of the preparation date of the pro forma financial statements).

Comfort Letter Considerations

As mentioned above, underwriters frequently request negative assurance comfort from auditors on pro forma financial information included in or incorporated into the offering documents. Auditors follow the guidance in AS 6101 when performing these procedures in response to an underwriter's request. We do not believe AS 6101 contemplates assurance on pro forma financial information that incorporates forward-looking information subject to a safe harbor or other MAs subject to significant management judgment. Accordingly, to minimize disruption to the capital raising process, we recommend that the Commission work with the PCAOB on any revisions to AS 6101 that may be necessary as a result of the revised Article 11 framework. Transition guidance may be needed to the extent AS 6101 is not revised prior to the amendments' effective date.

Alternatively, while we recognize the Commission's objective by requiring the use of MAs is to provide investors with insight into the potential effects of the acquisitions and the post-acquisition plans expected to be taken by management, the Commission could consider making MAs (or only the subjective MAs as described above) optional. If optional, a registrant could remove the MAs from the pro forma financial information and underwriters could receive customary comfort on such information as part of their due diligence process (thereby, reducing the likelihood that auditors become a speed bump, or roadblock, to the offering process).

Other

We have several observations on various aspects of the proposed text in Article 11:

- Proposed S-X Rule 11-02(b)(1) indicates that the historical statement of comprehensive income used in the pro forma financial information shall only be presented through "income from continuing operations (or appropriate modification thereof)." It is not clear to us what "modification" would be acceptable and we recommend that the Commission clarify what modifications may be appropriate.

- For transactions required to be accounted for by retrospectively revising the historical statements of comprehensive income, Proposed S-X Rule 11-02(c)(2)(ii) specifies that pro forma statements of comprehensive income shall be filed for "all periods for which historical financial statements of the registrant are required." We recommend that the Commission consider clarifying that the prior year interim period is not required for pro forma presentations depicting retroactive presentation (consistent with the staff guidance in paragraph 3230.2 of the FRM).

- Item 9.01(b)(1) of Form 8-K requires that "for any transaction required to be described in answer to this form, furnish any pro forma financial information that would be required pursuant to Article 11 of Regulation S-X." Accordingly, some registrants limit the pro forma presentation in Form 8-K to the currently reported acquisition without giving pro forma effect to any previously reported acquisitions or other transactions that also required Article 11 information. However, pro forma financial information included in a 1933 Act filing pursuant to Article 11 is required to include the effects of both transactions. We recommend the Commission clarify whether the requirement in Item 9.01(b)(1) of Form 8-K is to give effect to the current acquisition and previously reported transaction(s) as it results in more comprehensive disclosure (and eliminates the ambiguity in the Form's requirement).

Investment Company Considerations

We support the Commission's objective of tailoring financial reporting requirements for investment companies with respect to acquisitions of investment companies and other types of funds. However, we recommend that the Commission consider making the clarifications described below to avoid unintended consequences and additional costs for registered investment company registrants, including business development companies.

Proposed S-X Rule 1-02(w)(2)(ii) – Income test

- *Numerator* - We recommend that the Commission clarify whether the numerator for the tested subsidiary should be calculated as either the absolute value of the sum of investment income from dividends, interest, and other income, the net realized gains and losses on investments, and the net change in unrealized gains and losses on investments (Method 1) or the sum of the individual absolute values of each of these components (Method 2). For example, if investment income was $12, net realized loss on investments was $(9) and the net change in unrealized loss on investments was $(5), Method 1 would result in a calculation of $2 (absolute value of [$12-$9-$5]) while Method 2 would result in a calculation of $26 ($12+$9+$5). The proposed rule appears to imply an investment company would use Method 1 while Page 101 of the proposing release might imply an investment company would use Method 2. If Method 2 is to be used, there could be a double counting of realized gains and losses on investments and change in unrealized gains and losses on investments.

- *Five-Year Income Averaging Alternative*

  Meaning of "insignificant"

  The proposed rule provides an alternative measure for the denominator in the income test which is to use the average of the absolute value of the changes in net assets resulting from operations for the registrant and its consolidated subsidiaries for each of its last five fiscal years (Five-Year Income Averaging) when the change in net assets resulting from operations for the most recently completed fiscal year

is "insignificant". We agree that the Commission should permit an alternative calculation measure for the denominator, as an insignificant change for a recently completed year could potentially have adverse effects on the proposed income test for investment companies. However, we recommend the Commission provide clarity on what constitutes an "insignificant" change in net assets resulting from operations. Without clearly defining what constitutes "insignificant", there could be differences in interpretation and ultimately diversity in what is deemed to be a significant subsidiary from one registrant to another.

Accordingly, we recommend the Commission require Five-Year Income Averaging if the absolute value of the change in net assets resulting from operations of an investment company registrant and its subsidiaries consolidated is at least 10 percent lower than the average of the absolute value of such amounts for each of its last five fiscal years.

Whether Five-Year Income Averaging is required for S-X Rule 1-02(w)(2)(ii)(A)

The reason provided by the Commission for permitting the use of Five-Year Income Averaging by investment companies is "to further mitigate the potential adverse effects of the proposed income test for investment companies with insignificant changes in net assets resulting from operations for the most recently completed fiscal year." However, Five-Year Income Averaging is only included in the alternate income test in Proposed S-X Rule 1-02(w)(2)(ii)(B) but is not included in the 80% income test in Proposed S-X Rule 1-02(w)(2)(ii)(A). As the rationale above would apply to both of the Proposed Rules, it is not clear whether this difference was intentional. We recommend the Commission clarify whether an investment company is permitted to use Five-Year Income Averaging in the 80% income test in S-X Rule 1-02(w)(2)(ii)(A).

Other Considerations

- *Impact on S-X Rules 3-09 and 4-08(g)* - S-X Rules 3-09 and 4-08(g) refer to "subsidiaries not consolidated and 50 percent or less owned persons." We recommend that the Commission consider amending S-X Rules 3-09 and 4-08(g) to clarify that for registered investment companies and business development companies, these rules are applicable to unconsolidated subsidiaries that are controlled by registered investment companies and business development companies, in which "control" is as defined in Section 2(a)9 of the Investment Company Act of 1940.[1]

  We also believe the Commission should consider amending S-X Rules 3-09 and 4-08(g) such that a registrant that is a registered investment company or business development company should refer specifically to Proposed S-X Rule 1-02(w)(2) (instead of S-X Rule 1-02(w)).

[1] A similar conforming change would also apply to S-X Rule 10-01(b)(1) with respect to interim financial statements.

Lastly, S-X Rule 3-09 states that 20 percent should be substituted for 10 percent in the tests used in S-X Rule 1-02(w) to determine a significant subsidiary for purposes of attaching the financial statements of a significant unconsolidated subsidiary. It is unclear how this would apply to the thresholds in the Income Tests under Proposed S-X Rule 1-02(w)(2)(ii). Accordingly, we recommend the Commission consider amending S-X Rule 3-09 to clarify or provide the thresholds that should be substituted in Proposed S-X Rule 1-02(w)(2)(ii) for a registrant that is a registered investment company or a business development company.

- *Summarized Financial Information Required Under S-X Rule 4-08(g) -* We believe the Commission consider whether to modify S-X Rule 4-08(g)(ii) in a manner consistent with IM Guidance Update No. 2013-07, "*Business Development Companies—Separate Financial Statements or Summarized Financial Information of Certain Subsidiaries*" (the "Update") to permit summarized financial statements for only the unconsolidated controlled subsidiary(ies) that meet the thresholds in Proposed S-X Rule 1-02(w)(2). As stated in the Update, *"If a BDC is required to present summarized financial information, the Division generally would not object if the BDC presents summarized financial information in the notes to the financial statements only for each unconsolidated subsidiary which individually meets the definition of a "significant subsidiary" in Rule 1-02(w) but does not present summarized financial information in the notes to the financial statements for all unconsolidated subsidiaries."*

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We appreciate this opportunity to express our views to the Commission. We would be pleased to answer any questions the Commission or its staff might have about our comments. Please contact Tim Kviz, National Assurance Managing Partner – SEC Services, at [redacted] or via e-mail at [redacted], or Christopher Tower, National Managing Partner – Audit Quality and Professional Practice Leader, at [redacted] or via e-mail at [redacted].

Very truly yours,

BDO USA, LLP

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